Supreme Court, U.S.
FILED
MAR 10 2000
CLERK

No. 99-1214

In The

Supreme Court of the United States

CATERPILLAR INC., CATERPILLAR FINANCIAL SERVICES CORPORATION, AND SOLAR TURBINES INCORPORATED,

Petitioners,

v.

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, JR., THE NEW HAMPSHIRE COMMISSIONER OF REVENUE,

Respondents.

On Petition For A Writ Of Certiorari To The Supreme Court Of New Hampshire

PETITIONERS' REPLY BRIEF

WILLIAM F.J. ARDINGER
BRIAN T. TUCKER
RATH, YOUNG, AND PIGNATELLI P.A.
One Capital Plaza
Concord, NH 03301
(603) 226-2600

DANIEL J. SCHLICKSUP
CATERPILLAR INC.
100 N.E. Adams Street
Peoria, IL 61629-4295

PAUL H. FRANKEL
(*Counsel of Record*)
CRAIG B. FIELDS
AMY L. SILVERSTEIN
MEREDITH L. FRIEDMAN
MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, NY 10104-0012
(212) 468-8000

Counsel for Petitioners

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

13pp

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

I. RESPONDENTS FAIL TO REBUT THE DISCRIMINATION AGAINST CATERPILLAR.... 1

A. Respondents' Own Examples Confirm That Their Treatment Of Foreign Unitary Royalties and Interest Inevitably Results In Discrimination 1

B. Discrimination Inevitably Results Herein When the Proper Comparison is Made Between the Treatment of Foreign Unitary Royalties and Interest Without Factor Representation and the More Favorable Treatment of Domestic Unitary Royalties and Interest With Factor Representation 3

II. RESPONDENTS' SUGGESTION THAT ROYALTIES AND INTEREST ARE NOT TREATED THE SAME AS DIVIDENDS HAS NO RELEVANCE TO THE FOREIGN COMMERCE CLAUSE DISCRIMINATION ANALYSIS 5

III. THE DENIAL OF CERTIORARI IN CATERPILLAR'S MINNESOTA CASE SHOULD HAVE NO BEARING ON THIS PETITION..... 6

IV. RESPONDENTS' BRIEF CONTAINS OTHER INCORRECT ASSERTIONS CONCERNING THIS CASE 8

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES

Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992) 9

ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) 5, 6

Associated Indus. of Mo. v. Lohman, 511 U.S. 641 (1994) 4

Board of County Comm'rs v. Umbehr, 518 U.S. 668 (1996) 7

Caterpillar, Inc. v. Commissioner of Revenue, 568 N.W.2d 695 (Minn. 1997), *cert. denied*, 522 U.S. 1112 (1998) 6, 7, 8

General Tel. Co. of Northwest, Inc. v. EEOC, 446 U.S. 318 (1980) 7

Jackson v. Denno, 378 U.S. 368 (1964) 7

Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 505 U.S. 71 (1992) 8

Murtagh v. County of Berks, 634 A.2d 179 (Pa. 1993), *cert. denied*, 511 U.S. 1017 (1994) 7

National Private Truck Council, Inc. v. Oklahoma Tax Comm'n, 515 U.S. 582 (1995) 7

United States v. Carver, 260 U.S. 482 (1923) 7

STATUTES AND RULES

42 U.S.C. § 1983 7

N.H. Code Admin. R. Rev. 307.07(d) (currently, N.H. Code Admin. R. Rev. 307.07(c)) 5

I.

RESPONDENTS FAIL TO REBUT THE DISCRIMINATION AGAINST CATERPILLAR

A. Respondents' Own Examples Confirm That Their Treatment Of Foreign Unitary Royalties and Interest Inevitably Results In Discrimination.

The examples contained in Respondents' Brief confirm that discrimination will result in every instance where a domestic parent corporation moves the operations of a domestic unitary subsidiary to a foreign location. Respondents' examples illustrate the inevitable discrimination that occurs when the royalties and interest are paid by a domestic unitary subsidiary as compared to a foreign unitary subsidiary. In every instance the tax due is greater when the royalties and interest are paid by a foreign subsidiary.[1]

---

[1] The amount of tax due for each of Respondents' examples was determined by first multiplying the royalties and/or interest by the apportionment percentages determined by Respondents in each example to arrive at a tax base. The tax base was then multiplied by the tax rate of 8%. For example, for the example at 12a-13a in Appendix C, the $500 was multiplied by the 3.0706% apportionment percentage determined by Respondents to arrive at a tax base of $15.35. This tax base was then multiplied by the tax rate (*i.e.*, 8%) to arrive at a tax due of $1.23. Similarly, for the example at 14a-15a in Appendix C, the $500 was multiplied by the 3.1908% apportionment percentage determined by Respondents to arrive at a tax base of $15.95. This tax base was then multiplied by the tax rate (*i.e.*, 8%) to arrive at a tax due of $1.28.

Appendix C Examples	Royalties & Interest	**Tax Due with Domestic Subsidiary**	**Tax Due with Foreign Subsidiary**
12a-15a	$500	**$1.23**	**$1.28**
16a-17a	$20,000	**$29.33**	**$35.69**
18a-19a	$50,000	**$35.00**	**$36.56**
20a-21a	$500	**$1.05**	**$1.15**

In Appendix C, at 12a-15a (the first two examples involving the payment of unitary royalties and/or interest), the unitary subsidiary pays $500 of interest to its parent corporation. In the first example (at 12a-13a), where the subsidiary is a domestic corporation, the tax due on the $500 is $1.23. In the second example (at 14a-15a), where the subsidiary is now a foreign corporation, the tax due on the $500 is *increased* to $1.28. This increased tax is due to the fact that while the $500 is included in the tax base in each example, the apportionment percentage in the first example (*i.e.*, for the domestic subsidiary) includes the subsidiary's property, payroll and sales but the apportionment percentage in the second example (*i.e.*, for the foreign subsidiary) does not include that subsidiary's property, payroll and sales.

The same is true for each of the other examples included in Respondents' Appendix C – in each example the tax due on the element of foreign commerce would be higher if the subsidiary paying the royalties or interest were a foreign corporation as opposed to a domestic corporation. Thus, Respondents' examples demonstrate that discrimination is inevitable if the unitary royalties and interest are included in the parent's tax base and there is no inclusion in the apportionment computations of the unitary property, payroll and sales that generated such intragroup amounts.

B. Discrimination Inevitably Results Herein When the Proper Comparison is Made Between the Treatment of Foreign Unitary Royalties and Interest Without Factor Representation and the More Favorable Treatment of Domestic Unitary Royalties and Interest With Factor Representation.

Rather than attempting to take head on the irrefutable point that a corporation will always pay more tax on royalties and interest received from a foreign unitary subsidiary than on royalties and interest received from a domestic unitary subsidiary, Respondents have attempted to divert this Court's attention by erroneously shifting the focus to matters not at issue in this case. Respondents allege that in determining whether foreign commerce is impermissibly burdened, all of the provisions of the Business Profits Tax must be taken into account and that "[w]hen both the apportionment formula and the entire tax base are considered, it is not possible to establish that the Business Profits Tax will be higher for a parent corporation with a foreign subsidiary than for a parent corporation with a domestic subsidiary." Resp. Br. at 13-14.[2]

In effect, Respondents' argument reduces to the notion that New Hampshire law may discriminate against royalties and interest paid by foreign unitary subsidiaries because another aspect of the state's tax scheme arguably benefits the taxpayer by not imposing forced worldwide

---

[2] All references to "Resp. Br." are to Respondents' Brief in Opposition. References to "Pet." are to the Petition for a Writ of Certiorari.

combination.[3] However, as *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994), demonstrates, a state may not discriminate in any portion of its taxing scheme even if the taxpayer receiving the discriminatory treatment could enjoy unrelated benefits under other provisions of the same scheme.

In *Associated Industries*, this Court considered Missouri's use tax on goods purchased out-of-state at a statewide rate that was greater than the sales tax rate in some but not all localities. Because the use tax rate was equal to or lower than the sales tax rate in some localities, there were many situations in which the tax was not discriminatory. In fact, "in the aggregate, the tax scheme imposed greater burdens on intrastate than on interstate commerce." *Id.* at 646. However, the fact that the tax was discriminatory in some situations compelled this Court to strike down the tax in its discriminatory applications.

Unconstitutional discrimination in one aspect of a tax scheme cannot be cured by an attempt to dampen or mute the discrimination through another part of the tax law. In this case, focusing on Respondents' inclusion of royalties and interest from foreign unitary subsidiaries in the tax base without allowing factor representation in *every* circumstance produces a discriminatory result. Consequently, this particular aspect of the tax scheme is unconstitutional and must be struck down.

---

[3] Respondents are confused. Under worldwide combination, income and losses of foreign subsidiaries paying no dividends, no royalties and no interest would be included in the apportionable tax base. That situation has no relevance to this case.

II.

RESPONDENTS' SUGGESTION THAT ROYALTIES AND INTEREST ARE NOT TREATED THE SAME AS DIVIDENDS HAS NO RELEVANCE TO THE FOREIGN COMMERCE CLAUSE DISCRIMINATION ANALYSIS

Respondents attempt to camouflage the discrimination in this case by arguing that royalties and interest are treated differently than dividends for constitutional purposes. Resp. Br. at 17-19. Respondents' assertion is inconsistent with the stipulation in this case, their own administrative rules and with this Court's decision in *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982).

The parties have stipulated that all of the constituent members of the Caterpillar Unitary Business, including the Foreign Unitary Members, are engaged in the conduct of a single, integrated unitary business. Stip. ¶ 1. This stipulation assumes that the form of the intra-unitary group payments, including dividends, royalties or interest, is not important.

Moreover, Respondents' own administrative rules acknowledge that the form or character of an intragroup payment of intangible income is not relevant for purposes of taxation under the unitary business principle. Under these administrative rules, all intragroup payments within the water's edge combined group, regardless of their characterization, are "eliminated" and treated as if they had not been made, for purposes of determining the income of the group that is apportionable to, and taxable by, New Hampshire. N.H. Code Admin. R. Rev. 307.06(d) (currently, N.H. Code Admin. R. Rev. 307.07(c)).

Respondents' assertion also ignores this Court's ruling in *ASARCO* that intangible income of types other than dividends merit the same fundamental constitutional protections. *ASARCO* involved not only whether dividends

from ASARCO's out-of-state and foreign subsidiaries were includable in its apportionable base, but also whether interest and capital gains were so includable. This Court found that ASARCO was not engaged in a unitary business with its out-of-state and foreign subsidiaries that generated the dividend, interest and capital gains, and therefore the amounts were not includable in its apportionable tax base. This Court saw no justification for different constitutional protections between dividends on the one hand, and other types of income from intangibles (such as interest) on the other:

> Idaho and ASARCO agree that interest and capital gains income derived from [ASARCO's subsidiaries] should be treated in the same manner as the dividend income. We also agree. *"One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability."*

ASARCO, 458 U.S. at 330 (citations and footnote omitted, emphasis added).

Therefore, the fact that an intragroup payment is characterized as a dividend, royalty or interest, does not have relevance to the analysis in this case. This is because – as the stipulation in this case, Respondents' administrative rules, and fundamental constitutional principles all confirm – the form of an intragroup payment of intangible income is not relevant for purposes of taxation under the unitary business principle.

III.

THE DENIAL OF CERTIORARI IN CATERPILLAR'S MINNESOTA CASE SHOULD HAVE NO BEARING ON THIS PETITION

Respondents, at Resp. Br. at 9-11, make much of this Court's denial of certiorari in *Caterpillar, Inc. v. Commissioner of Revenue*, 568 N.W.2d 695 (Minn. 1997), *cert.*

denied, 522 U.S. 1112 (1998) ("*Caterpillar Minnesota*"), contrary to principles espoused by this Court numerous times regarding the denial of certiorari. *See, e.g., United States v. Carver*, 260 U.S. 482, 490 (1923) ("[t]he denial of a writ of certiorari imports no expression upon the merits of the case, as the bar has been told many times").

Despite Respondents' contentions to the contrary, the denial of certiorari in *Caterpillar Minnesota* does not mandate a similar denial in this case. This Court has a history of granting certiorari in cases where the identical issue was presented previously but certiorari was denied. For example, in *National Private Truck Council, Inc. v. Oklahoma Tax Commission*, 515 U.S. 582 (1995), this Court granted certiorari to resolve a conflict among state courts regarding remedial relief for Commerce Clause violations under 42 U.S.C. § 1983, where certiorari previously had been denied in a case involving the identical issue. *See id.* at 585-86 (citing *Murtagh v. County of Berks*, 634 A.2d 179 (Pa. 1993), *cert. denied*, 511 U.S. 1017 (1994)); *see also Board of County Comm'rs v. Umbehr*, 518 U.S. 668 (1996) (certiorari granted to resolve conflict among federal courts regarding First Amendment issue where certiorari on same issue was previously denied); *General Tel. Co. of Northwest, Inc. v. EEOC*, 446 U.S. 318 (1980) (certiorari granted to resolve conflict among federal courts regarding Title VII class action issue where certiorari on same issue was previously denied); *Jackson v. Denno*, 378 U.S. 368 (1964) (certiorari granted to resolve conflict among state courts regarding Fourteenth Amendment issue where certiorari on same issue was previously denied).

Given the current conflict among the state courts regarding factor representation, and given the importance of this issue to the states as well as to taxpayers, this Court should grant certiorari on this Petition.

Moreover, this case more clearly demonstrates, than did *Caterpillar Minnesota*, the blatant facial discrimination that exists against foreign commerce. As illustrated in the instant Petition (Pet. at 3), the resulting tax inevitably increases when a parent corporation moves a subsidiary located exclusively in Maine across the St. Lawrence River to Quebec. *See Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin.*, 505 U.S. 71, 74 n.10 (1992).

Furthermore, this case more clearly emphasizes the two-part test of the unitary business principle. As discussed in the Petition, either New Hampshire should not include the foreign royalties and interest in the tax base (Part A of the unitary business principle) or, if it includes such unitary payments in the base, it should include the factors of the unitary corporations that generated such amounts in the calculation of the apportionment formula (Part B of the unitary business principle).

Therefore, the denial of certiorari in the Minnesota case should have no bearing on this Petition.

IV.

RESPONDENTS' BRIEF CONTAINS OTHER INCORRECT ASSERTIONS CONCERNING THIS CASE

Respondents make other incorrect assertions concerning this case. Respondents incorrectly assert that Petitioners are attempting to "substantially broaden" their constitutional claims before this Court. Resp. Br. at 8-9. This is not true. Petitioners have always asserted that the Department's inclusion of the foreign unitary royalties and interest in Caterpillar's apportionable tax base, without including the foreign unitary apportionment factors that generated such income in the denominator of the apportionment formula, discriminates against foreign commerce.

Respondents, perhaps recognizing their vulnerability with respect to the defenses they attempt to raise concerning the merits of their constitutional position, incorrectly assert that the remedy of exclusion of the foreign unitary income from the tax base was abandoned by Petitioners. Resp. Br. at 16 n.10. This is not true, as is demonstrated by Respondents' failure to refer to any part of the record to support their incorrect assertion. Petitioners have always objected to the state's overreaching and its modification of the unitary business principle. Moreover, Petitioners are not asking this Court to fashion a remedy to the discrimination but have merely indicated that there are remedies that comport to constitutional taxation.

Respondents are also incorrect, as was the court below, when they state that royalties and interest received from the Foreign Unitary Members are the same as royalties and interest received from third parties. Resp. Br. at 7-8. The royalties and interest received from the Foreign Unitary Members, if includable at all in Caterpillar's New Hampshire tax base, are includable only because of the existence of the stipulated unitary relationship. Payments from third parties, however, never satisfy the unitary business relationship requirement. Moreover, royalties and interest received from third parties can serve an investment function of the recipient corporation. *See Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 787 (1992). Therefore, Respondents' statements that all payments by unrelated third parties would be includable in the apportionable tax base are incorrect.

The final and most misleading claim made by Respondents is that Petitioners are challenging New Hampshire's use of water's edge combination rather than worldwide combination. Resp. Br. at 20-23. This is a gross mischaracterization of Petitioners' challenge. Petitioners

agree wholeheartedly with the policy concerns that caused New Hampshire (and other States) to abandon taxation on a "worldwide combination" basis in favor of a "water's edge" system. Petitioners' complaint is that New Hampshire's water's edge system violates the Foreign Commerce Clause because of its inconsistent application of the unitary business principle. By including the royalties and interest of the Foreign Unitary Members without the same apportionment allowed to income of the Domestic Unitary Members, New Hampshire is disregarding the unitary business principle and, therefore, is engaging in discriminatory, extraterritorial taxation against foreign commerce. It is this disregard of the unitary business principle to which Petitioners object.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

WILLIAM F.J. ARDINGER
BRIAN T. TUCKER
RATH, YOUNG, AND PIGNATELLI P.A.
One Capital Plaza
Concord, NH 03301
(603) 226-2600

DANIEL J. SCHLICKSUP
CATERPILLAR INC.
100 N.E. Adams Street
Peoria, IL 61629-4295

PAUL H. FRANKEL
(Counsel of Record)
CRAIG B. FIELDS
AMY L. SILVERSTEIN
MEREDITH L. FRIEDMAN
MORRISON & FOERSTER LLP
1290 Avenue of the Americas
New York, NY 10104-0012
(212) 468-8000

Counsel for Petitioners

Dated: March 9, 2000